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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1687

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee for The Port Authority of New York and New Jersey Consolidated Bonds, Fortieth and Forty-First Series, on its own behalf and on behalf of all holders of Consolidated Bonds of The Port Authority of New York and New Jersey and all others similarly situated,

Appellant,

v.

THE STATE OF NEW JERSEY, BRENDAN T. BYRNE, Governor of the State of New Jersey, and WILLIAM F. HYLAND, Attorney General of the State of New Jersey,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

~~MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND~~ BRIEF *AMICUS CURIAE*

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August 12, 1976

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ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Securities Industry Association through its Public Finance Division hereby respectfully moves for leave to file the accompanying *amicus curiae* brief in the above-described action in support of the appeal herein by appellant, United States Trust Company of New York. The consent of counsel for the appellant has been obtained. The consent of counsel for the appellees was requested but counsel declined to consent "at this time." On June 28, 1976 this

Court granted the Securities Industry Association's motion for leave to file a brief *amicus curiae* in support of appellant's jurisdictional statement.

The interest of the Public Finance Division of the Securities Industry Association in this case arises from the fact that its members will be directly and substantially affected by the ultimate outcome of this litigation, as they have been already affected by the repeal of the statutory covenant enacted by the states of New Jersey and New York in 1962 which was for the benefit of holders of Consolidated Bonds of The Port Authority of New York and New Jersey ("1962 Covenant") and by the decision rendered in this case by the Superior Court of the State of New Jersey and affirmed by the Supreme Court of the State of New Jersey.

The Securities Industry Association is a trade association representing 650 securities firms whose members underwrite and deal in all types of securities including those of state and local governments, corporations and the federal government and its agencies. Its members constitute a broad cross-section of the securities industry—investment bankers, brokers, dealers, underwriters, and bond departments of banks, who participate in the financing of bonds and notes of states and local governments. The Public Finance Division of the Association has a vast wealth of collective experience in, familiarity with, and expertise with respect to the securities market for obligations of state and local governments, a unique market.

The Public Finance Division is confident that appellant will adequately present the importance to holders of Consolidated Bonds of the Port Authority of this Court's decision on the constitutionality of repeal of the 1962 Covenant. However, the Public Finance Division is singularly able to present facts concerning the impact of the decision on the constitutionality of the repeal on the municipal bond mar-

ket generally, on the borrowing ability of state and local governments for whom Public Finance Division members act as investment bankers and financial advisors, and on the general investing public. The Public Finance Division respectfully submits that the general importance of the questions presented to this Court requires that such facts be presented by the Securities Industry Association through its Public Finance Division as *amicus curiae.*

August 12, 1976

Respectfully submitted,

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Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF *AMICUS CURIAE*

The Securities Industry Association, through its Public Finance Division, respectfully submits this brief in support of the appeal to this Court by appellant United States Trust Company of New York, from the judgment of the Supreme Court of New Jersey, entered February 25, 1976, affirming the decision of the Superior Court of New Jersey, Bergen County, which upheld the constitutionality of Chapter 25 of the Laws of New Jersey of 1974 which retroac-

tively abrogated a valid statutory covenant between the states of New Jersey and New York and bondholders of The Port Authority of New York and New Jersey ("Port Authority") securing such Port Authority bonds in the principal amount of $1.26 billion (such statutory covenant is hereinafter referred to as the "1962 Covenant").

Interest of Amicus Curiae

The Securities Industry Association is a trade association representing 650 securities firms whose members underwrite and deal in all types of securities including those of state and local governments, corporations and the federal government and its agencies. Its members constitute a broad cross-section of the securities industry—investment bankers, brokers, dealers, underwriters, and bond departments of banks, who participate in the financing of bonds and notes of states and local governments. Members of the Securities Industry Association underwrite more than ninety-five per cent of all long-term debt of states and local governments.

The state and local government securities market, commonly called the municipal securities market, represents approximately 39% of the net new funds raised each year in the United States capital markets (excluding the federal government and its agencies). The municipal securities market is one of the fastest growing sectors of the United States capital market. The volume of state and local government financing has increased dramatically since 1960 from an annual level of $11.5 billion in 1960 to $60 billion by 1975. As a result, total outstanding indebtedness of state and local governments grew from $71 billion at the end of 1960 to $222.8 billion by the end of 1975. The proceeds of long-term bonds issued by state and local governments were applied for the following purposes:

(Billions of Dollars)

Purpose	1960	1970	1972	1974	1975
Education	2.28	5.03	4.98	4.73	4.70
Transportation	1.31	3.17	2.99	1.71	2.20
Utilities and conservation	1.30	3.47	4.68	5.64	7.30
Water and sewer	1.02	2.40	2.45	1.99	2.30
Pollution control			.60	1.71	2.20
Other utility and cons.	.28	1.07	1.64	1.94	2.70
Social welfare	.60	1.47	3.82	4.45	4.60
Public housing	.43	.13	1.92	1.69	.70
Hospitals	NA	NA	.50	.78	2.0
Other	.17	1.30	1.41	1.98	1.80
Industrial aid	.04	.11	.33	.50	.50
Others (general purpose)	1.53	4.20	5.30	6.50	10.0
New capital	7.06	18.00	22.12	23.51	29.6
Refunding	.05	.11	1.57	.73	1.00
Total	7.11	18.11	23.69	24.24	30.6

The ownership of holdings is reflected in the following table:

(Billions of Dollars)

	1950		1960		1970		1975	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Banks	8.2	32.6	17.7	25.0	70.2	48.0	102.8	46.1
Individuals	10.0	39.6	30.8	43.5	47.4	32.5	67.5	30.3
Fire & Casualty Insurance	1.1	4.4	8.1	11.5	17.8	12.2	34.3	15.4
Others	5.9	23.4	14.2	20.0	10.8	7.3	18.2	8.2
Total	25.2	100	70.8	100	146.2	100	222.8	100

Source: Federal Reserve Board of Governors.

The Securities Industry Association considers it of vital importance that this Court consider the potentially disastrous consequences to the public interest that could result if the repeal of the 1962 Covenant is upheld—namely, the consequent lessening of the ability of state and local governments to obtain access to the credit markets.

The problems presented are exacerbated by two additional considerations: (1) the demand for obligations of state and local governments has become extremely volatile because the major institutional investors on whom the

market relies for support are particularly subject to the pressures of monetary policy, the impact of inflation and sudden changes in portfolio policies; and (2) assuming the validity of the repeal, it is doubtful that the capital markets will have the capacity to absorb desired levels of state and local borrowing at rates of interest that state and local governments are willing to pay. See, Joint Economic Committee, 94th Cong., 20 Sess., Changing Conditions In The Market For State and Local Government Debt, (Joint Comm. Print 1976); see also, Staff of Subcommittee on Economic Progress of the Joint Economic Committee, 89th Cong., 20 Sess., State and Local Public Facility Needs and Financing (Joint Comm. Print 1966).

A holding that the repeal legislation is valid would severely limit, if not foreclose, the access of municipal borrowers to the capital market—with the ultimate result that public interests could not be served, since capital needs of municipal issuers could not be fulfilled.

SUMMARY OF ARGUMENT

The repeal of the 1962 Covenant jeopardizes the foundation of municipal credit generally and thus is in derogation of the paramount public interest in protecting the borrowing power and credit of state and local governmental units. Accordingly, the repeal legislation cannot be upheld as a valid exercise of the state's police power since the legislation itself threatens the ability of the states to accomplish their public purposes.

Furthermore, this Court has consistently held that in response to an emergency a state may only impair such contractual obligations which, in themselves, either directly contribute to the emergency or prevent its solution. Since the continued existence of the 1962 Covenant neither contributed to nor precluded a solution of the mass transit problem, its repeal cannot be justified as an exercise of the state's police power.

ARGUMENT

I.

The Repeal of the 1962 Covenant Jeopardizes the Foundation of Municipal Credit Generally and is Thus in Derogation of the Paramount Public Interest in Protecting the Borrowing Power and Credit of State and Local Governmental Units.

In explaining the necessity for states to retain certain limited power to meet dire emergencies in the public interest, the exercise of which would result in the impairment of contractual obligations, this Court in *Home Bldg. & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398 (1934) noted that "the policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worthwhile—a government which retains adequate authority to secure the peace and good order of society." Id at 435. If the challenged legislation enacted under the guise of a state's police power has the effect of creating an emergency even greater than that sought to be cured by the legislation, that legislation would be antithetical to the very premise upon which the residuum of state power is based. That is to say, if the challenged legislation itself—rather than the emergency it purports to cure—threatens the "maintenance of a government by virtue of which contractual relations are worthwhile", then clearly such challenged legislation cannot be upheld as a valid exercise of the state's police power.

The legislation repealing the 1962 covenant, if upheld by this Court, will have just such an adverse effect in that it poses a real and substantial threat to the foundation of municipal credit generally and the continued viability of municipal bonds as an acceptable investment able to compete in credit markets with other credit instruments.

The financing of obligations of state and local governments is based upon reliance by prospective purchasers on the security of and source of payment for the obligations.* Assurance of payment and continuation of the inviolability of the security for such payment are essential to a proper functioning of the market for such obligations. In turn, the continuation of an effective operation of state and local governments is dependent upon such governments' access to capital markets. Such access is dependent upon the continued integrity of the security and source of payment of such obligations, as well as the integrity of the pledges and contractual undertakings made with respect to such obligations.

In *Perry* v. *United States*, 294 U.S. 330 (1934) this Court recognized that an obligation to secure and repay a loan is among the most sacrosanct of obligations when the borrower is a sovereign:

> "There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the

* Obligations of state and local government are generally of two types: general obligations and revenue obligations. General obligations are secured by the issuer's pledge of its full faith, credit and taxing power. Revenue obligations are payable from revenues derived from tolls, charges or rents paid by those who use the facilities constructed with the proceeds derived from the sale of the obligations or other facilities owned by the issuer of the obligations (such as the Consolidated Bonds of the Port Authority). General obligations and revenue obligations are seldom, if ever, secured by mortgages on the issuer's property. As stated in *Faitoute Iron & Steel Co.* v. *City of Asbury Park*, 316 U.S. 502, 509 (1942): "The principal asset of a municipality is its taxing power and that, unlike an asset of a private corporation, cannot be available for distribution. An unsecured municipal security is therefore merely a draft on the good faith of a municipality in exercising its taxing power".

Thus, because the property of state and local governments is generally exempt from levy and execution, greater emphasis must be given to their promises, their contracts, their covenants to assure their acceptability in the credit markets.

> Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers."
>
> • • •
>
> "By virtue of the power to borrow money 'on the credit of the United States,' the Congress is authorized to pledge that credit as an assurance of payment as stipulated,—as the highest assurance the Government can give, its plighted faith.
>
> • • •
>
> ". . . The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the Government,—upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations." *Id.* at 350-351, 351, 353.

Thus, this Court held in *Perry* that the United States, as a sovereign borrower, could not withdraw its "plighted faith" pledged in order to induce private lenders to loan it money, even under emergency conditions such as prevailed during the depression.

The basis for the decision in *Perry* was this Court's recognition of the paramount public interest in protecting the credit of governmental units. For if by reason of a repudiation of its "plighted faith" a governmental unit is denied access to the credit markets and is thus deprived of its economic power to borrow money on its credit—"a power vital to the Government,—upon which in an extremity its very life may depend" (*Id.* at 353)—then the continued viability of such government would be threatened. In such a situation the governmental unit may have

solved a problem only to find that by so doing it has rendered itself helpless to effectively deal with any real emergency—and indeed may have prompted financial emergencies by the manner in which it solved the problem.

The sanctity of municipal bond obligations, even in the face of economic crises, was recognized by this Court in a series of post Civil War decisions. *E.g., Von Hoffman* v. *City of Quincy,* 71 U.S. (4 Wall) 535 (1866); *Wolff* v. *City of New Orleans,* 103 U.S. 358 (1880); *Louisiana* v.*Pilsbury,* 105 U.S. 278 (1881). In striking down the remedial legislation and affording protection to bondholders, this Court was pursuing what it perceived as a paramount goal—inducing investor confidence in municipal obligations notnotwithstanding dire economic reverses of the issuer. The Court recognized the need for such assurance in view of the unique nature of municipal obligations.

Municipal obligations often remain outstanding for many years, through changes of administrations and composition of legislative bodies of governmental issuers. In view of the fact that alterations in the obligations may be sought as a result of changes in leadership and policy, investors *must* be assured of the inviolability of the duties imposed by their bond contracts. Such assurance enables municipal issuers to borrow capital at reasonable interest rates. Such assurance, upon which investment in municipal obligations is based, is founded upon (1) the rule that the statutes under which bonds are issued are an integral part of the bond contract and (2) the provision in Article I Section 10 of the United States Constitution that "No State shall . . pass any . . . Law impairing the Obligation of Contracts. . . ."

The 1962 Covenant was enacted as a direct result of, and as a specific response to, concern in the investment community that the assumption by the Port Authority of the deficit-ridden Hudson and Manhattan Railroad ("H&M"), now PATH, would set a precedent for the assumption by the Port Authority of other perpetual deficit projects. The 1962 Covenant, which was described by the Farley committee as a "constitutionally-protected statutory covenant" (ST 184),* allayed such investor concern** and following its enactment $1.26 billion of Port Atuhority bonds were purchased.*** The most distinctive aspect of the repeal of the 1962 Covenant, and the reason it will have such a devastating effect on investor confidence and municipal credit if upheld by this Court, is that the 1962 Covenant was the two states' *specific* and *single* response to investor concern

* "ST" references are to pages of the Stipulation among counsel before the Superior Court, dated December 20, 1974. "T" references are to pages of the Trial Transcript before the Superior Court; and "P" references are to plaintiff United States Trust Company of New York's trial exhibits.

** Since the enactment of the 1962 covenant, the Port Authority has emphasized the importance of the Covenant to induce potential investors to purchase Consolidated Bonds. The Covenant was described as a legally enforceable contract (T58-1 to 59-11; P-36, P-38), was discussed in detail in every official statement of the Port Authority distributed in connection with the sale of Consolidated Bonds since 1962 and was discussed at information sessions held in connection with the sale of Consolidated Bonds of the Port Authority (T6 -20 to 64-16, P1, P2, ST 330-335).

*** The salient point in the instant case is that the 1962 Covenant was "a substantial inducement" to buyers of Port Authority bonds. In *City of El Paso* v. *Simmons,* 379 U.S. 497 (1965), so heavily relied upon by the New Jersey Superior Court, the unlimited right in perpetuity to reinstatement of a forfeited contract to buy land was never bargained for by any buyer. As this Court said the buyers in *El Paso* could not, and did not, expect the unlimited right of reinstatement to be of "everlasting effect" (*Id.* at 514). The 1962 Covenant was *limited* to the life of the bonds. The statute in *El Paso* was a remedial statute of repose to alleviate an unforeseen and unexpected development. In contrast, the repeal legislation in the instant case repudiates a pledge made for the precise purpose of allaying the fear of bond buyers who *foresaw* that the states might seek to alleviate the then existing crisis in mass transportation by siphoning off Port Authority funds into ever expanding deficit operations.

prompted by the proposed takeover by the Port Authority of the deficit ridden H&M. This fact distinguishes this case from all other impairment cases which this Court has decided. The record below abounds with evidence that the Port Authority could not take over the H&M and continue to market its bonds at reasonable rates, if at all—except upon passage of the 1962 Covenant (ST 74, 76-77, 147, 165, 178, 179, 182, 183, 184). The Superior Court acknowledged that the 1962 New Jersey Legislature had itself reached this conclusion:

> "[T]he fact of the matter is that the Legislature of 1962 concluded it was necessary to place a limitation on mass transit deficit operations to be undertaken by the Authority in the future so as to promote continued investor confidence in the Authority." *United States Trust Company of New York* v. *The State of New Jersey,* 134 N.J. Super 124, 178, 338 A.2d 833, 863-64 (Law Division 1975)

In short, the bondholders have been misled;* they purchased the bonds at the prices offered because of the existence of the Covenant and either would not have purchased the bonds at all without the Covenant or would have purchased them only at a substantially lower price. Thus, at the hearing before the Superior Court, Mr. Gordon Fowler,

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* Mr. Lester Murphy, a Vice President of Barr Brothers & Co. Inc., one of the largest dealers in Port Authority bonds, testified as follows:

> "Q. Is the fear then that by the repeal of the covenant the Port Authority now is going to suddenly completely enwrapped in mass transit? A. No, I think that the fears, I think I've previously testified to, is that it's a—it's an abrogation of an agreement, it's a contract. It's as if I went and bought a car from General Motors and had a twelve month warranty, and all of a sudden they announced that it's only good for six months. I don't think that I'd buy another General Motors car. And I think this is the feeling in the investment community." (T 435)

Secretary of Connecticut General Life Insurance Company, testified as follows:

> "Q. In your purchases between 1968 [and] 1973 [in] the secondary market, were you aware of the existence of the 1962 covenant? A. Yes, I was.
>
> Q. Did the existence of the covenant affect your decisions to purchase those bonds? A. I relied on it at the time I purchased the bonds, yes".
>
> • • •
>
> Q. With respect to all the purchases you described [approximately $9½ million of Port Authority bonds], would you have purchased any of those bonds without the protection of the covenant? A. I can't say for certain we would not have purchased them, but if we had, it would have been at a much lower price for the given coupons" (T765).

Mr. John F. Thompson, an eminent investment banker and municipal analyst and Vice President of W. H. Morton & Co., gave similar testimony:

> "Q. And did you personally look to the covenant and depend on it? A. Oh, certainly. That was—certainly was an important and significant part of what I presumed we were buying for our clients when we purchased those bonds that I speak of.
>
> Q. Which were those, just to make sure its clarified? A. This is when I was at [Scudder, Stevens & Clark, a major financial advisor] and there were at least two instances where we purchased Port Authority bonds for several clients. In each instance, the total amount was at least a million dollars of bonds" (T82).
>
> Q. Assuming everything else to be equal, but if the covenant had not been enacted would those purchases have been made?
>
> • • •
>
> "The Court: Well, would you have recommended, then, the purchase of the bonds?

The Witness: I would not have recommended them at the price which they were then offered" (T83).

• • •

Q. If you knew that the covenant would later be repealed would you have recommended the Port Authority bonds during the '60s? A. No." (T86).

The reason why investors would not have purchased Port Authority bonds without the Covenant, or only at substantially lower prices, was further explained in a law review article entitled "The Contract Clause as the Guardian Against Legislative Impairment of Municipal Bondholder's Rights":

> "A bond investor is willing to take a relatively fixed risk in exchange for a fixed return. The type of risk is then utilized in determining the amount of interest he will require for the use of his capital. The 1962 covenant was enacted in order to attract large sums of capital by setting limits on the risk which the Port Authority could undertake in the precarious area of deficit rail operations. Since the Port Authority lacks the power to tax or to pledge the credit of either State the covenant was designed to protect the only source for payment of expenses and over $1 billion in bond obligations—the Authority's revenues." 6 SETON HALL L. REV. 48, 78 (1974).

The Superior Court itself recognized that the price paid and the interest rate fixed for such bonds reflects the investor's evaluation of the underlying security of the issue, and that purchasers of Port Authority Consolidated Bonds after enactment of the Covenant relied on the Covenant in purchasing such bonds at the prices they paid:

> "Port Authority consolidated bonds are known in the market place as revenue bonds, *i.e.*, they are payable solely from the revenues and reserve funds derived

from the facilities operated by the Authority. In the main these bonds are sold to relatively sophisticated institutional investors either for their own accounts or for the accounts of others whose investment funds they manage. Since the bonds carry a fixed rate of return and must compete against other similar types of securities available in the market place, the interest rate fixed when the bonds are initially marketed, as well as the price of the bonds in the secondary market, will normally reflect the investor's evaluation of the underlying security of his investment and the prevailing interest rates available on similar types of securities."

• • •

"Based upon the testimony offered by plaintiff, the investment community's understanding of the covenant was that it in some manner furnished 'security for the bondholders and it protected the diversion of the earnings of the Port Authority into deficit mass rail transit.' If the covenant is to be understood in that sense, the record supports plaintiff's claim that investors relied on the covenant in purchasing Authority bonds." *United States Trust Company of New York* v. *The State of New Jersey, supra,* 134 N.J. Super at 177, 179, 338 A.2d at 863, 864.

In light of the repudiation of their "solemn pledge", it cannot be seriously disputed that the credit worthiness of New Jersey, New York, and their political subdivisions has been and will continue to be impaired to such a degree that the very ability of these entities to raise capital at reasonable rates is endangered. At the hearing Mr. Thompson testified (a) that if the Governor of New Jersey had recommended repeal of the Covenant *before* the sale of $300,000,000 of bonds of the New Jersey Sports and Exposition Authority instead of one week *after* the sale, the bonds would not have been saleable, and (b) that many institutional investors now refuse to purchase *any* obligations of

New Jersey or New York or their political subdivisions because of the repeal:

> "In my opinion—and I have heard no professional investment person who disagreed with this; in my opinion if that recommendation by the Governor had been made one week before the sale of the Sports Complex bonds instead of one week after, the bonds would not have been saleable; because the investment community was saying about the repeal of the covenant, and has said about it: If a legal covenant can be repealed by the States, what confidence can we place in their moral obligation?
>
> "We have run into this in an even broader field. My firm was the number two manager in a syndicate which last week underwrote $150 million and sold them of Power Authority bonds of the State of New York.
>
> "Now the Power Authority is not dependent upon a moral obligation. It is dependent on its own revenues which are from the sale of electric power. It is about as far removed from any emotional, or as far removed from the feeling I just stated as anything could be. And yet we found in several parts of the country that there were many institutional investor portfolio managers who had themselves adopted or their investment committees had adopted a rule that there be no further investment in anything in New York State or New Jersey due to the repeal of the Covenant." (T87).

The serious adverse effect repeal of the Covenant had on the credit of New York State and its agencies was described in the Report to the Governor issued by the New York State Moreland Act Commission on the Urban Development Corporation and Other State Financing Agencies.

> "Since early 1975, the State has had to rely on emergency measures to keep several agencies and the largest city in the nation from default. Financial markets have been either closed to the State and its authorities or are demanding premium interest rates for all government sponsored capital projects, even those for financially sound communities."

• • •

> "One factor contributing to New York's 1975 bond market problems was the 1974 repeal of a covenant of the Port Authority of New York and New Jersey which had restricted the use of excess funds for mass transit. The transfer of excess funds to other purposes must be done only in accordance with understandings in effect at the time bonds are sold, in order to protect the State's credit and keep faith with bondholders."

• • •

> "The financing programs of the Dormitory Authority, Port Authority and Power Authority, although they consist largely of straight revenue bonds, clearly affect the State's credit. Their aggregate borrowings are substantial, and there are a number of indirect relationships between their operations and the State's finances. Moreover, their operations can occasion disputes, as exemplified by the Port Authority bond covenant, that can directly affect the State's financial credibility."

• • •

"An example of market reaction is found in an October 18, 1974 letter from the Fireman's Fund American Insurance Companies to Mr. Belica. Noting that the Fireman's Fund had approximately $165 million par value New York State, HFA and Port Authority bonds in its portfolio, the writer stated:

> 'The abrogation of this covenant without consent or compensation, I believe, is not only illegal, but shortsighted. You are aware that credit rests not only on covenants between borrower and issuer, but also importantly on trust. With this action, the bond holder's faith in New York State has been

shaken resulting in high interest rates and poor investor acceptance as subsequent sales by New York State agencies and authorities have shown. It is my belief that the best way to begin to reestablish investment confidence is a court overturn of this legislation with publicly stated approval from State officials.'" Moreland Act Commission [New York State] on the Urban Development Corporation and Other State Financing Agencies, "Restoring Credit and Confidence: A Reform Program for New York State and Its Public Authorities" (New York, 1976), pp. 9, 24, 100, 163.

The view as to the adverse effect repeal has had on the credit of the two states and their subdivisions was echoed in the above-mentioned law review article:

"The New York and New Jersey legislatures, in repealing the 1962 covenant, have impaired a constitutionally protected obligation. The practical repercussions of this repudiation—not of a moral pledge but of a solemn legal pledge—were recently noted in *Moody's Bond Survey:*

'What does the repeal of a legal obligation, the basis for the Port Authority's covenants, imply with respect to moral obligations? If the States are willing to repeal a legal obligation used as the basis for selling bonds without regard for possible litigation and uncertainty, what chance does a moral obligation have in a period when sufficient political pressures arise? Or, to phrase another question: When or under what circumstances would a State legislature find it expedient not to make a contribution to a capital reserve fund? The answer, if the Port Authority example provides one, is when it may be politically expedient.'

The repeal of the covenant, if *Moody's* is an indication, has already significantly undermined investor confidence in the trust-worthiness of the two states.

This erosion can result in higher interest rates for New Jersey's public authorities and agencies seeking to finance their public projects. Is this a price worth paying—especially when repeal of the covenant does not insure that the Port Authority will, in fact, be able to undertake any additional deficit rail operations? The confidence of the banking and investment community in the two states would be restored by a clear judicial expression that the repeal of the 1962 covenant violates the impairment of contracts clause, is not a proper exercise of police power, and, therefore, is unconstitutional." 6 SETON HALL L. REV. at 80-81.

Investors who purchase long-term municipal obligations want and need to be assured that the issuer's contractual obligations won't be impaired for any reason, and certainly want to be assured that such obligations are not subject to "political risks". As set forth above, this Court has traditionally recognized the unique nature of such obligations and the importance of assuring investors of the inviolability of the pledges of a government unit's "plighted faith." The repeal of the 1962 Covenant was an act of political expediency and the investment community recognized it as such. Under any circumstances that act could not be justified as a valid exercise of the state's police power and certainly cannot justify an abrogation of a covenant in a municipal debt obligation which was enacted for the very purpose of inducing investors to purchase the obligations in reliance on the Covenant. If this Court were to uphold the repeal of the 1962 Covenant, the future of municipal bonds would be seriously jeopardized because vulnerability to political pressures is the opposite of the certainty and stability which prudent investors require.

II

The Continued Existence of the 1962 Covenant did not Preclude a Solution to the Transit, Energy and Pollution Problems and Therefore Its Repeal Cannot be Justified as an Exercise of the State's Police Power

The common thread in the cases in which this Court has upheld an impairment is the fact that the obligation impaired actually directly contributed to the emergency or prevented its solution. In the instant case, however, the 1962 Covenant did not directly contribute to the transit, energy and pollution problems, nor did it prevent their solution. Accordingly, the repeal of the 1962 Covenant cannot be justified as an exercise of the state's police power.

The key passage in this Court's lengthy opinion in *Home Bldg. and Loan Ass'n.* v. *Blaisdell, supra,* is the following:

> "The question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end. Another argument, which comes more closely to the point, is that the state power may be addressed directly to the prevention of the enforcement of contracts *only when* these are of a sort which the legislature in its discretion may denounce as being *in themselves* hostile to public morals, or public health, safety or welfare, or where the prohibition is merely of injurious practices; *that interference with the enforcement of other and valid contracts according to appropriate legal procedure, although the interference is temporary and for a public purpose, is not permissible.* This is but to contend that in the latter case the end is not legitimate in the view that it cannot be reconciled

> with a fair interpretation of the constitutional provision." 290 U.S. at 438-39 (emphasis added).

In *Blaisdell* the contractual right to foreclose and evict during an emergency contributed directly to the emergency and such emergency could not be solved without the temporary modification of that right. If the right of foreclosure were not temporarily suspended, the mortgagees would have been deprived of their equity for all time. Thus, the Court held that the State could validly exercise its police power to restrain temporarily the enforceability of a contractual obligation "where vital public interests would *otherwise* suffer. . . ." *Id.* at 440 (emphasis added). This Court was faced with a similar situation in *Block* v. *Hirsch,* 256 U.S. 134 (1921) when it upheld a temporary suspension of landlords' rights to regain possession after lease expirations in view of the scarcity of housing in the District of Columbia after the war. In both cases the impairment was a necessary and essential means of averting the threatened injury. Likewise, in *W. B. Worthen Co.* v. *Kavanaugh,* 295 U.S. 56, 63 (1935), this Court noted the requirement for establishing the *necessity* of the impairment as a means of averting the threatened harm, and in *East New York Savings Bank* v. *Hahn,* 326 U.S. 230, 234 (1945) this Court noted the significance of a legislative finding that the public welfare *required* the impairment. Finally, in *City of El Paso* v. *Simmons, supra,* the Court noted that the imposition of a five year statute of repose was "quite clearly necessary" in order to avert the public injury. 379 U.S. at 516.

The law review article referred to above draws the same distinction:

> "The Supreme Court [in *W. B. Worthen Co.* v. *Kavanaugh,* 295 U.S. 56 (1935)] has indicated that the courts are loath to accept modifications of bondholders' rights, even if an economic crisis exists. In

fact, legislative impairment of bondholders' rights because of the economic crisis has been permitted only when *any other result* would lead to total fiscal collapse of the bond issuer and the impossibility of payment of the bonds. *Such is not the case of the Port Authority. Any emergency which may exist in the field of mass transit is not caused by the covenant, might or might not be alleviated by its repeal, and certainly may be solved by other, constitutionally inoffensive methods.*" 6 SETON HALL L. REV. at 85 (emphasis added).

That it was unnecessary to repeal the 1962 Covenant in order to deal with the mass transit problem was recognized by the Court in *Kheel* v. *The Port of New York Authority,* 331 F.Supp. 118, 122 (S.D.N.Y. 1971), aff'd, 457 F.2d 46 (2d Cir.), cert. denied, 409 U.S. 983 (1972):

> "• • • from a pragmatic point of view, the transit amendment's [1962 Covenant's] constraint upon non-self-supporting rail facilities does not even temporarily preclude the state legislatures from dealing with mass transit problems by other means, e.g. by enactment of subsidy programs."

In the instant case the 1962 Covenant did not directly contribute to the transit, energy or pollution problems; nor did the Covenant prevent a solution to these problems. The *most* that can be said for repeal is that it *might possibly* free-up certain moneys (insignificant sums in comparison to the mass transit problem) for improvements in mass transit facilities and that such improvements *could* lead to the use of less automobiles in the Port District which would, in turn, result in some diminution of fuel consumption and automobile emissions. Clearly, however, such a tenuous connection with the alleged "emergencies" cannot meet the constitutional test, as stated in *Blaisdell,* that contracts may be impaired only when they are

"in themselves hostile to public morals, or public health, safety or welfare. . . ." 290 U.S. at 438. Moreover, since there are other, more effective and constitutionally inoffensive methods to solve these alleged "emergencies" it cannot be said, as required by *Blaisdell,* that but for the impairment "vital public interests would otherwise suffer. . . ." *Id.* at 440.

Conclusion

No one can predict the extent of the negative impact of upholding the repeal of the 1962 Covenant upon the future financing of public corporations which have no recourse to the taxing power; but it is safe to predict that, though yesterday's unqualified pledge may seem today to some to have been improvident, to equivocate now on the meaning and significance of that pledge would be more improvident. Private capital, not money raised by taxation, made the bridges, tunnels, and port improvements of the Port Authority possible. A decision that the reserved power of states does not supersede the Contract Clause will go a long way towards protecting and preserving the credit of these states and their political subdivisions for posterity.

The 1974 legislation purporting to repeal the 1962 Covenant made by the states of New York and New Jersey to holders of Consolidated bonds of the Port Authority violates the Contract Clause of the Federal Constitution and should be declared void.

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